NATIONAL TAXPAYERS UNION FOUNDATION
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October 27, 2023

D.C. Tax Revision Commission
1101 4th Street S.W., Suite W770
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By email

Dear Commission:

On behalf of National Taxpayers Union Foundation ("NTUF"), we write with additional information the Commission should consider before proceeding with Proposal B-5 (Provide guidance on P.L. 86-272). P.L. 86-272 is a federal law that allows businesses that engage only in certain sales activities to pay income tax only in their home jurisdiction.

The proposal would, without any change to the underlying federal law, essentially **strip the certainty and protections** of the Interstate Income Act of 1959 (P.L. 86-272) for **any business, large or small, with a website** or modern sales methods. Importantly, this is separate from requiring such businesses to collect sales tax on their sales, a law D.C. has already enacted. This would impose income tax on such businesses even if they have no property or no non-sales employees in the District. The largest businesses already have nexus in most of the country (and D.C.), so this would primarily harm small and medium-sized businesses.

This has been characterized as a model reform but has been **adopted by no states, except California and New York** where tax administrators are attempting to enact them by regulation and not legislatively. Adoption by D.C. would therefore place D.C. in a category by itself in business unfriendliness.

Introduction

For nearly five decades, NTUF has striven to give policymakers the tools to make informed, pro-taxpayer policy choices. Our Interstate Commerce Initiative has sought to draw attention to the growing problem of states taxing and regulating outside their borders, creating burdensome and often overlapping systems that taxpayers have to figure out how to navigate.

A Radical Reinterpretation of Federal Law Presented as a Technical Change

What has been presented as a mere technical change aimed at preventing "tax avoidance" among out-of-state businesses would represent, in truth, a radical expansion of the BFT to businesses that utilize modern technology to provide convenience to D.C.-based consumers.

P.L. 86-272 most importantly protects foreign businesses from facing corporate income tax nexus if their sole activity in a state is:

> "the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State."

For decades, this has been understood to apply to online sales. Yet, the proposed changes to the interpretation of P.L. 86-272 would restrict P.L. 86-272's protections to only the most minimalist online operations.

While technological change requires taxing authorities to remain flexible, it should not be used as an excuse to extend nexus to businesses that would not face D.C. BFT obligations for using traditional, less convenient alternatives. Unfortunately, that is exactly what adopting the Multistate Tax Commission's (MTC) guidance, which "has been widely panned by [tax] practitioners," would result in.

Many of the examples of activities the MTC guidance argues are not protected by P.L. 86-272 would strip out-of-state businesses of the law's protection for the most mundane online activity. Consider some of the specific activities that the MTC argues are not protected by P.L. 86-272:

> "The business regularly provides post-sale assistance to in-state customers via either electronic chat or email that customers initiate by clicking on an icon on the business's website. For example, the business regularly advises customers on how to use products after they have been delivered."

Email and electronic "chat," much like phone calls, are convenient alternatives to a D.C. consumer traveling all the way to a foreign business's out-of-state location to ask questions — or even mailing a letter to the same businesses. Would the latter activities expose a foreign business to D.C.'s BFT? No, and D.C. should consider an alternative approach that would be consistent with this non-digital equivalent.

> The business's website invites viewers in a customer's state to apply for non-sales positions with the business. The website enables viewers to fill out and submit an electronic application, as well as to upload a cover letter and resume.

Less "advanced" (or convenient) alternatives include accepting emailed job applications from D.C. residents, allowing D.C. residents to mail in job applications to a foreign location, and letting D.C. residents to travel to a foreign location to hand in a job application in person. Would

any of these activities expose a foreign business to D.C. BFT nexus? No, and D.C. should consider an alternative approach that would not create this inconsistency.

> The business places Internet "cookies" onto the computers or other electronic devices of in-state customers. These cookies gather customer search information that will be used to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale. This in-state business activity defeats the business's P.L. 86-272 immunity because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property.
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> The business places Internet "cookies" onto the computers or other devices of in-state customers. These cookies gather customer information that is only used for purposes entirely ancillary to the solicitation of orders for tangible personal property, such as: to remember items that customers have placed in their shopping cart during a current web session, to store personal information customers have provided to avoid the need for the customers to re-input the information when they return to the seller's website, and to remind customers what products they have considered during previous sessions. The cookies perform no other function, and these are the only types of cookies delivered by the business to its customers' computers or other devices. This in-state business activity does not defeat the business's P.L. 86-272 immunity because it is entirely ancillary to the in-state solicitation of orders for sales of tangible personal property.

Both of these activities involve digital "cookies," which do not have much of a traditional counterpart. Nevertheless, they remain an integral part of any modern browsing experience.

The distinction between the use of cookies in these above examples assumes a separability that may not exist in reality. For example, cookies "gathering customer information" such as "items placed in shopping carts" and "remind[ing] customers what products they have considered during previous sessions" would be difficult to not use to adjust production schedules and inventory amounts. In other words, though the latter example theoretically sets out an example of a business that still enjoys the protection of P.L. 86-272, it appears highly unlikely that this extremely restrictive definition would allow for any real-life foreign businesses to use cookies and still enjoy the protection of P.L. 86-272.

What's more, past attempts to assert nexus on the basis of foreign businesses' use of cookies have failed in other states. Earlier this year, the Massachusetts Supreme Judicial Court struck down an effort by the state of Massachusetts to assert sales tax nexus on an out-of-state business retroactively because of that business's use of cookies. D.C. should consider an alternative approach consistent with the Massachusetts legal decision.

<u>Arguments In Favor of This Change Are Unconvincing</u>

Arguments put forward by advocates of this change should not sway the Commission to move forward with such a radical reinterpretation of federal law. Point-by-point:

- *"Broadens the tax base"*: While this is true, broadening the tax base is something that policymakers should seek to do with businesses that *already have nexus*. Attempting to

impose the BFT on all businesses nationwide, for example, would certainly broaden the tax base, but that would not make such a tax justifiable or advisable.

- "*Supports local retailers, wholesalers, and manufacturers"*: Purely local retailers, wholesalers, and manufacturers that do not sell across state lines benefit from a far simpler tax compliance landscape, not having to familiarize themselves with every state's varying tax laws all around the country. The businesses that pose the greatest threat to small businesses are large operations that already have physical presence around the country and entire state and local accounting departments dedicated to managing their tax compliance in states and localities across the country — and would therefore be unaffected by this proposed change. In fact, the unmanageability of these cumulative compliance burdens have been pushing small online retailers onto larger platforms that promise to handle their state and local taxes for them.

- *"Tax falls on non-DC businesses"*: This an explicit acknowledgement of what makes this proposed change so susceptible to legal challenges under the Commerce Clause of the Constitution, and shows how other states could just as easily respond by forcing the same treatment on D.C. businesses. This would result in a revenue shell game with no one winning and the businesses hit with additional compliance obligations all losing.

- *"Transparency"*: Under current law, it is clear what is protected. Removing those protections is the exact same amount of transparency.

- *"Follows the lead of other states"*: Only two states have begun the process of adopting this change. The Commission should take this as evidence of most other states' uncertainty about the legal sturdiness of the MTC's position.

Conclusion

Adopting the MTC proposal would be at the cost of D.C.'s ability to position itself as a competitive and friendly jurisdiction for businesses to sell into. What's more, it would create a clear and harmful burden on interstate commerce that would leave the District vulnerable to legal challenges.

Rather than adopting the MTC's aggressive position, D.C. should embrace and encourage businesses' ability to use modern technology to offer convenience and competition to D.C. consumers.

Yours Very Truly,

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